INFORMATION BULLETIN

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June 29, 2006

Harmonization to certain measures of the federal budget of May 2, 2006 and other fiscal measures

This information bulletin describes the position of the ministère des Finances concerning the measures proposed in the federal Budget Speech of May 2, 2006.

In addition, it details the changes made to certain fiscal measures, including the eligibility of a new category of organizations – those operating in the community media sector – to issue receipts for donations and gifts, and the increase to $750 000 of the maximum amount that can be claimed regarding a show eligible for the tax credit for the production of shows.

For information on the issues dealt with in this information bulletin, contact the Secteur du droit fiscal et de la fiscalité at (418) 691-2236.

The French and English versions of this bulletin are available on the website of the ministère des Finances at: www.finances.gouv.qc.ca

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Finances Québec

Harmonization to certain measures of the federal budget of May 2, 2006 and other fiscal measures

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1. MEASURES RELATING TO THE MAY 2, 2006 FEDERAL BUDGET SPEECH

On May 2, 2006, the Minister of Finance of Canada presented the federal government's budget for 2006. This budget announces various fiscal measures that affect the tax system.

1.1 Measures relating to the Income Tax Act

When he tabled the 2006 budget, the Minister of Finance of Canada tabled, in the House of Commons, supplementary information as well as a Notice of Ways and Means Motion to Amend the *Income Tax Act*.

These documents propose measures of which some had been released in the federal budget of February 23, 2005, the Economic and Financial Update of November 14, 2005 or the Department of Finance of Canada News Release 2005-082 of November 23, 2005.

While the ministère des Finances du Québec has already stated its position on the measures released during 2005 by the federal government, it is appropriate to confirm it, since these measures could not be passed before the prorogation of the Parliament of Canada because of the general election.

In addition, it is appropriate to make the position of the ministère des Finances du Québec known regarding the new measures proposed in the supplementary information and the Notice of Ways and Means Motion.

However, the measures retained will be adopted only after the approval of any federal law or the adoption of any federal regulation giving effect to them, taking into account technical amendments that might be made prior to the approval of the law or the adoption of the regulation. These measures will generally apply on the same dates as for the purposes of the federal income tax system.

❑ Measures retained

Québec's tax legislation and regulations will be amended to incorporate, with adaptations on the basis of their general principles, the measures relating to:

1. the taxation of the Universal Child Care Benefit (BR 6),[1] subject to the clarifications below;

2. capital gains of fishers (RB 7), provided that the rules designed to prevent provincial tax avoidance in cases where separate elections are possible, under federal and provincial tax legislation, will apply regarding the elections stipulated by such tax rules;

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1 The references in parentheses correspond to the number of the budget resolution of the Notice of Ways and Means Motion to Amend the *Income Tax Act* tabled on May 2, 2006.

3. the implementation of a deduction for tradespeople's tools expenses (BR 9 and BR 10);[2]

4. the adjustment to the deduction for apprentice vehicle mechanics' tools costs (BR 11), subject to the clarifications below;

5. the increase in the refundable medical expense supplement from $750 to $1 000 (BR 16 a));[3]

6. the elimination of capital gains tax resulting from a gift of publicly-listed securities and ecologically sensitive land (BR 18);

7. the inclusion of the apprenticeship grant in the calculation of income (BR 19);

8. the concept of eligible dividends and the gross-up rate of income relating thereto, provided that these measures shall apply regarding dividends paid or deemed paid after March 23, 2006 (BR 20);[4]

9. the extension from 10 to 20 years of the carry-forward period for non-capital losses, farm losses and restricted farm losses (BR 28);[5]

10. the tax credit for severe and prolonged mental or physical impairment (BR 36), except for the amendments dealing with therapeutic care essential to maintain vital function;[6]

11. the disability supports deduction (BR 37);[7]

12. the addition of certain expenses to the list of eligible expenses for the purposes of the non-refundable tax credit for medical expenses (BR 38);[8,9]

13. the deduction for depreciation for tools;[10]

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2 For greater clarity, as of taxation year 2008, the threshold of $1 000 beyond which the deduction applies will, like the major parameters of the personal tax system, be automatically indexed. Where the amount resulting from the indexing is not a multiple of 5, it will be adjusted to closest multiple of 5 or, if it is equidistant from two multiples of 5, to the nearest greater multiple of 5.

3 The decision to retain this measure was announced in Information Bulletin 2005-7 of December 19, 2005.

4 The decision to retain these measures and, more generally, the decision to change the tax treatment of dividends had been announced in the March 23, 2006 Budget Speech (*Additional Information on the Budgetary Measures*, Section 1, p. 116 to 118).

5 *Supra*, note 3.

6 The decision to retain this measure, except where it bears on therapeutic care essential to maintain vital function, was announced in the April 21, 2005 Budget Speech (*Additional Information on the Budgetary Measures*, Section 1, p. 133). Moreover, the changes concerning therapeutic care are not retained, because Québec's tax system is satisfactory in this regard.

7 The decision to retain this measure was announced in the April 21, 2005 Budget Speech (*Additional Information on the Budgetary Measures*, Section 1, p. 133).

8 Including the additions to this list consisting of regulatory changes and arising from the measure proposed in this regard by the federal government in its 2005 budget and confirmed in its 2006 budget, on page 244 of the document entitled *The Budget Plan 2006* from the Department of Finance Canada.

9 The decision to retain this measure was announced in the April 21, 2005 Budget Speech (*Additional Information on the Budgetary Measures*, Section 1, p. 133).

10 DEPARTMENT OF FINANCE CANADA, *The Budget Plan 2006*, p. 238.

14. accelerated capital cost allowance for forestry bioenergy;[11]

15. all the changes concerning the deduction for depreciation applicable to certain types of property.[12]

❑ Clarifications regarding certain retained measures

Some measures that will be incorporated into Québec's tax legislation will be modulated in a particular way.

Accordingly, the measure relating to the taxation of the Universal Child Care Benefit will be adapted so that the benefit is included in the calculation of taxable income. Thus, the Universal Child Care Benefit will not be included in the calculation of the amount of assistance granted to households by the various transfer programs and refundable and non-refundable tax credits that reduce with income.

The measure designed to adjust the parameters of the deduction for apprentice vehicle mechanics' tools costs (BR 11) will also be adapted so that the amount of $1 000 that enters into the calculation of this deduction is replaced, for new tools acquired after May 1, 2006, with an amount corresponding to the total of $500 and the amount used to calculate the deduction for tradespeople's tools expenses and that constitutes, for a given year, the threshold of eligible tool expenses beyond which this deduction applies.[13]

Lastly, despite the harmonization with the concept of eligible dividend and the rate of gross-up of the income relating thereto, there is reason to specify that Québec's legislation stipulates different dividend tax credit rates than those stipulated by the federal legislation. Accordingly, in relation to a dividend paid or deemed paid after March 23, 2006, the rate of the tax credit applicable regarding an eligible dividend will be 11.9%, while that applicable regarding an ordinary dividend will be 8%.

❑ Measures not retained

Some measures have not been retained because they do not correspond to features of Québec's tax system or because Québec's tax system has no corresponding provisions. Such is the case with the measures relating to the mineral exploration tax credit (BR 8), the textbook tax credit (BR 12), the corporate surtax (BR 23), the extension from 10 to 20 years of the carry-forward period for investment tax credits, losses applied under Part IV of the *Income Tax Act* and taxable life insurance investment losses in Canada under Part XII.3 of this Act (BR 28) and the minimum tax of financial institutions (BR 32).

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11 DEPARTMENT OF FINANCE CANADA, *The Budget Plan 2006*, p. 239. The decision to retain this measure was announced in Information Bulletin 2005-7 of December 19, 2005.

12 DEPARTMENT OF FINANCE CANADA, *The Budget Plan* 2006, p. 244. The decision to retain this measure was announced in the April 21, 2005 Budget Speech (*Additional Information on the Budgetary Measures*, Section 1, p. 134).

13 I.e. the threshold of $1 000 that will be indexed automatically as of taxation year 2008.

Other measures have not been retained because Québec's tax system is satisfactory in their regard. These measures concern:

— the basic personal income tax rate (BR 1);

— the basic personal amounts (BR 2 to BR 4);

— scholarships and bursaries (BR 13);

— the pension income amount (BR 14);

— the child disability benefit (BR 15);

— the refundable medical expense supplement reduction threshold (BR 16 b));

— the tax credit for public transit passes (BR 17);

— the general corporate income tax rate (BR 21 and BR 22);

— the small business deduction limit (BR 24 to BR 26);

— the small business rate (BR 27);

— the federal capital tax (BR 29 to BR 31);

— the apprenticeship job creation tax credit (BR 33);

— the deferral of dividends of agricultural cooperatives (BR 35);

— the non-refundable tax credit for medical expenses – natural caregivers (BR 40);

— the non-refundable tax credit for adoption expenses (BR 41);

— the children's fitness tax credit.[14]

The measure relating to the Canada employment credit (BR 5) is not retained.[15] However, this tax credit will be taken into consideration for purposes of determining the Work Premium reduction thresholds.

The rules in place to determine these thresholds require the reconstitution of the gross work income of households, assuming that such income constitutes a salary and taking into account, among other things, the federal income tax attributable thereto. For the purposes of calculating such tax, only certain tax credits must be taken into consideration, in particular those specific to wage-earners, such as the tax credit for employment insurance contributions.

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14 DEPARTMENT OF FINANCE CANADA, *The Budget Plan 2006*, p. 226 and 227.

15 Québec's tax system is satisfactory in this regard.

The Canada employment credit has a direct impact on a wage-earner's federal income tax. The rules in place to determine the reduction thresholds of the Work Premium will therefore be changed, as of taxation year 2007, to stipulate that the Canada employment credit must be taken into consideration in calculating the federal income tax used for the purposes of reconstituting the gross work income of households.

❑ Subsequent announcement

- **Tax return in a functional currency**

Briefly, the federal measure regarding a tax return in a functional currency enables corporations that, for their financial reports, are required to report their income in a functional currency other than the Canadian dollar, to determine their income for Canadian tax purposes in such functional currency.[16]

The Minister of Finance of Canada announced that he intended to release draft legislative proposals for discussion purposes. Consequently, the decision of the Minister of Finance of Québec regarding this measure will be announced subsequently.

1.2 Measures relating to the Excise Tax Act

In the federal Budget Speech of last May 2, it was announced that the rate of the goods and services tax (GST) would be reduced from 7% to 6% as of July 1, 2006.

As such, this reduction in the federal tax rate will have little impact on Québec's sales tax system (QST) since its rate will remain unchanged. However, some changes will be made to the QST to reflect, in particular, the fact that the GST is part of the consideration on which the QST is calculated.

Changes to the QST system

❑ Consequential amendments

The required consequential amendments will be made to the *Act respecting the Québec sales tax* to reflect the effect of the reduction of the federal tax rate on certain amounts stipulated in the Act that were set taking the GST into account. Such is the case, for instance, for the rounding-off factors for certain cash registers and the maximum rebate amount for new houses and new rental buildings that will change from $5 642 to $5 607.

16 DEPARTMENT OF FINANCE CANADA, *The Budget Plan 2006*, p. 245.

❑ Transitional rebate regarding a residential complex

In the case of a sale of a new residential complex or a substantially renovated residential complex, carried out under a written contract concluded before May 3, 2006, it is stipulated that the GST will apply at the rate of 7%, even if the ownership and possession of the complex are transferred after June 30, 2006. However, to reflect the 1% reduction in the rate of the GST, a transitional rebate may be claimed by a purchaser in such a situation.[17]

Since the QST will have been paid on the amount of GST covered by a transitional rebate, the Québec tax system will be amended to allow a person entitled thereto to claim the rebate of the QST thus paid on such amount.

❑ Taxable benefit tied to the costs of operating an automobile

The GST and QST systems stipulate that if a registrant supplies a good or a service to its employee or its shareholder giving rise to a benefit whose value must be included in calculating the income of the employee or the shareholder under the *Taxation Act* and the *Income Tax Act* respectively, the registrant must then add in the calculation of his net tax a certain amount of GST or of QST, as the case may be, determined regarding such taxable benefit.

In the case of a taxable benefit relating to the costs of operating an automobile, the amount of the tax that must be included in the calculation of the net tax corresponds, in the GST system, to 5% of the value of the benefit and, in the QST system, to 5.7% of such value.

To reflect the reduction in the rate of the GST as of July 1, 2006, the 5% rate stipulated in the federal tax system will be reduced to 4.5% for taxation year 2006 and to 4% thereafter.

Since the federal rate is used for the purposes of determining the stipulated rate in the Québec tax system, the latter will be adjusted accordingly. The QST system will thus be amended to reduce the 5.7% rate to 5.5% for taxation year 2006 and to 5.3% for subsequent taxation years.

❑ Harmonization with certain federal measures

Among the measures implemented in the federal tax system with the reduction of the rate of the GST, some will be retained for the purposes of the QST system even though the rate of this tax is not changed.

Thus, the QST system will be amended to incorporate, with adaptations based on its general principles, the federal measures concerning the anti-avoidance provisions covering sales of real property by a public sector body to a person with whom it is not at arm's length, as well as the rules regarding the revocation of an election made by a public service body under the terms of section 211 of the *Excise Tax Act*.

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17 A transitional rebate may also be obtained in the case of a deemed supply under the terms of section 191 of the *Excise Tax Act*.

These harmonization measures will be adopted only after the approval of any law or the adoption of any regulation stemming from the May 2, 2006 federal Budget Speech, taking into account technical amendments that might be made prior to the approval of the law or the adoption of the regulation. The measures will be effective on the same dates as for the purposes of the GST system.

Clarifications regarding the QST system

❑ Quick accounting methods

To simplify accounting for small businesses and certain public service bodies, the QST system, like the GST system, includes quick methods that enable them to determine their net tax payable by applying prescribed rates to the total receipts from their taxable supplies, including GST and QST, rather than to establish the QST collected on each of their supplies and that paid on most of their purchases.

Since the rates currently prescribed in the QST system do not depend on the tax rate applicable in the GST system, no change will be made in their regard.

❑ Simplified method for calculating rebates regarding an expense account

To facilitate administration of the QST, Revenu Québec allows, by administrative policy, a simplified calculation method to be used to determine the QST rebates that an employer, a partnership and a charity or a public institution may claim regarding expenses reimbursed to an employee, an associate or a volunteer respectively.

According to this method, the input tax rebates (ITR) of small and medium-sized businesses and the partial rebates of the QST of charities, eligible non-profit organizations and specified public service bodies, may be established by applying the mathematical factor 7/107 to the total amount of expenses reimbursed, rather than doing an exact calculation of the tax paid. For large companies, the mathematical factor applicable is 4.1% because of restrictions on obtaining an ITR applicable to the latter regarding certain goods and services.

Despite the reduction of the rate of the GST, the mathematical factors of 7/107 and 4.1% will remain unchanged, since the tax rate applicable in the federal system has no impact on these factors.

1.3 Measures relating to standardized accounting

Briefly, the measures announced in the federal Budget Speech in relation to standardized accounting cover the harmonization of provisions concerning administration, interest and penalties relating especially to the *Excise Tax Act* as to the GST, but also to the *Excise Tax Act* as to other taxes it stipulates, to the *Income Tax Act*, the *Excise Act, 2001* and the *Air Travellers Security Charge Act*.[18]

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18 DEPARTMENT OF FINANCE CANADA, *The Budget Plan 2006*, p. 239 to 244.

These measures, which are part of an initiative taken by the federal government to implement an integrated set of rules covering the payment of taxes and the calculation of interest and penalties, are designed to simplify the application of the federal tax system.

In Québec, the *Act respecting the ministère du Revenu* already stipulates an integrated set of rules covering a large part of the administrative aspects relating to the application of Québec tax laws.

In this context, the ministère des Finances, working with Revenu Québec, is currently analyzing these federal measures relating to standardized accounting, and the decisions in this regard will be announced at a later date.

2. OTHER FISCAL MEASURES

2.1 Gifts to certain cultural or communications organizations

The tax system authorizes several entities to issue tax receipts for donations or gifts they receive from individuals or corporations. These receipts allow donors to obtain tax benefits.

In the case of individuals, these tax benefits essentially take the form of a non-refundable tax credit calculated at a rate of 20% for the first $200 taken into consideration and a rate of 24% for the remainder. In the case of corporations, the tax benefits are mainly in the form of a deduction made in calculating their taxable income.

To give rise to the tax credit or the deduction, as the case may be, donations and gifts must be made to recognized entities. In some instances, entities are recognized simply because they are public entities, as is the case of the state and municipalities. In other instances, recognition is granted on an individual basis, as in the case, for example, of charities and certain arts organizations.

To better reflect the cultural character of recognized arts organizations and foster the funding of organizations operating in the community media sector – which in particular contribute to the diversification of information sources and the democratization of access to media –, a new category of organizations will be authorized to issue receipts for donations and gifts, bearing the mention that they are Québec income tax receipts.

In addition to the arts organizations currently recognized, this new category will include organizations that are registered with the Minister of Revenue as cultural or communications organizations.

❑ Registration conditions

The Minister of Revenue may register an organization, at its request, as a cultural or communications organization, if he is of the opinion that it meets the following conditions:

— it was recommended by the Minister of Culture and Communications for registration as such;

— it is a person that constitutes a club or an association established exclusively for non-profit purposes;

— it is not a registered charity.

For greater clarity, the Minister of Revenue will be able to revoke the registration of an organization if it fails to satisfy any of the conditions required to be entitled to registration. For example, the registration of an organization may be revoked if the latter ceases to be recommended by the Minister of Culture and Communications for registration as a cultural or communications organization.

Moreover, as of the day following the day of publication of this information bulletin, no organization may subsequently obtain recognized artistic organization status and all organizations that were, on the day of publication of this bulletin, recognized arts organizations will be deemed, subject to the power of the Minister of Revenue to revoke a registration, to be registered as a cultural or communications organization with the Minister of Revenue.

❑ Calculation of the tax credit or deduction for donations and gifts

Donations and gifts made, after the day of publication of this information bulletin, to a cultural or communications organization whose registration is effective when the donations or gifts are made (hereinafter called a "registered cultural or communications organization"), may give rise to the tax credit or deduction for donations and gifts, under rules that are similar to those that apply to charitable donations.

More specifically, the tax legislation will be amended to stipulate that, for the purpose of calculating the tax credit or deduction for donations and gifts, the total eligible amount of donations and gifts made by a taxpayer during a given taxation year, other than gifts of property with undeniable ecological value and gifts of cultural property or similar gifts, will be calculated by taking into account the eligible amount of all gifts made by the taxpayer in the course of the year or, if the gift can be carried forward to that year, in the course of a previous year,[19] to a registered cultural or communications organization.

As a result of this change, donations and gifts to a registered cultural or communications organization will, in particular, be subject to the limit, generally set at 75% of the donor's income, on the total of the eligible amounts of the gifts, other than gifts of property with undeniable ecological value and gifts of cultural property or similar gifts, that may be taken into account in calculating the tax credit or deduction for donations and gifts.

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19 Essentially, in the case of individuals, any unused portion of a donation or gift made in a given taxation year may be carried over to one of the five subsequent taxation years, whereas in the case of corporations, any unused portion of a donation or gift made in a taxation year ending after March 23, 2006 can be carried over to one of the 20 subsequent taxation years.

Moreover, for greater clarity, where a taxpayer donates a work of art – as this expression is understood in the tax legislation – to a registered cultural or communications organization, other than such an organization that acquires the work of art in the course of its primary mission, the taxpayer will be deemed not to have donated the work of art, unless the donee disposes of it no later than December 31 of the fifth calendar year following that in which the donation or gift was made.

❑ Rules relating to the expenditures of registered cultural or communications organizations

A registered cultural or communications organization will be required to spend, in a given taxation year, for artistic, cultural or communications activities carried on by it or by way of gifts made by it to qualified donees, amounts that are at least equal to its disbursement quota for the year.

To this end, the expression "qualified donee" will refer to one of the following entities:

— the State or Her Majesty in right of Canada or a province;

— a Canadian municipality;

— a municipal or public body performing a function of government in Canada;

— an institution or public authority designated under the *Cultural Property Export and Import Act*;

— a certified archival centre;

— a national arts service organization validly registered as such;

— a registered museum.

In addition, a gift made by a registered cultural or communications organization to another registered cultural or communications organization constituted for purposes similar to those for which it was itself constituted will be considered a gift made to a qualified donee.

As for the expression "disbursement quota," it will have essentially the same meaning as that currently used for recognized arts organizations.

In brief, the disbursement quota of a registered cultural or communications organization for a given taxation year will correspond, where the organization has never, among other things, received gifts qualifying as enduring property,[20] to an amount that is at least equal to 80% of the aggregate of all amounts each of which is the eligible amount of a gift for which the organization issued, in the course of its preceding taxation year, a Québec income tax receipt.

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20 In general, enduring property refers to a gift received as a legacy or inheritance, direct distributions of proceeds of a life insurance policy, a registered retirement savings plan (RRSP) or a registered retirement income fund (RRIF) to an organization that is the designated beneficiary, or a gift that is subject to a trust clause or direction to the effect that the organization must hold it for a given period.

Rules similar to those that apply to registered charities will, however, be provided for so as to enable a registered cultural or communications organization to accumulate property for certain specific purposes. Furthermore, the Minister of Revenue will have the power to ease the obligation to expend to which these organizations will be subject.

In addition, to allow Revenu Québec to ensure compliance with this obligation to expend, registered cultural or communications organizations will be required to file an information return for each of their fiscal years within six months of the end of the fiscal year. In regard to keeping registers and records, they will also be required to follow rules similar to those that apply to registered charities.

Should a registered cultural or communications organization not comply with its obligation to expend, for a given taxation year, it will be required to pay Revenu Québec, within six months of the end of that year, an amount equal to the additional amount it would have been required to expend in that year to comply with its obligation.

Failure to comply with the obligation to expend may result in the revocation of a cultural or communications organization's registration. In addition, the registration of such organization may be revoked if it makes a payment in the form of a gift, other than a gift made as part of its activities, to an entity that is not, for the purposes of its obligation to expend, a qualified donee. For greater clarity, the reasons for revoking registration that habitually apply[21] will also apply to registered cultural or communications organizations.

Lastly, the authorization held by a registered cultural or communications organization to issue tax receipts for donations and gifts stipulating that said receipts are valid for Québec income tax purposes may be suspended, if the organization violates the requirements regarding the keeping of registers and records or if it acts in collusion with an organization under suspension in such a way as to accept a gift on that organization's behalf.

However, registered cultural or communications organizations may have recourse to the objections process in respect of certain notices issued by the Minister of Revenue, including those concerning the suspension of such authorization.

❑ Consequential amendments

Consequential amendments will have to be made to the current tax legislation and regulations to reflect the new category of registered cultural or communications organizations. These amendments will, among other things, result in stipulating:

— that a donation or gift made to a recognized arts organization may give rise to a tax credit or deduction for donations and gifts, only if it is made no later than the day of publication of this information bulletin;

— that an organization may be registered as a museum[22] only if it is not a registered cultural or communications organization;

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21 For example, the issuing of a receipt for a donation or gift that contains false information or failure to file an information return within the prescribed time limit.

22 Registered museum status confers the right to issue, regarding donations and gifts, receipts bearing the mention that they are Québec income tax receipts.

— that a taxpayer must include, in calculating his income, the value of the benefits relating to a workshop, a seminar, a training program or similar development program that a person receives or that it enjoyes, because of the fact that the taxpayer is a member of a registered cultural or communications organization.

2.2 Adjustment to the refundable tax credit for adoption expenses

A taxpayer who adopts a child is entitled to a refundable tax credit equivalent to 30% of the eligible adoption expenses that he or his spouse pays if the adoption process is completed. The amount of adoption expenses eligible for this tax credit is limited to $20 000. Thus, taxpayers who adopt a child may claim a refundable tax credit of up to $6 000.

For the purposes of this tax credit, adoptive parents may include, in calculating eligible adoption expenses, certain travel and living expenses. Essentially, this means reasonable expenses paid for a trip that enables the adoptive parents to join the child either in a foreign country or in a major urban centre in Québec to which the child has been escorted, and to return the child to their home.

However, eligible expenses do not include the travel and living expenses of parents who adopt a child who resides in Québec, because the youth centres that are responsible for the adoption of such a child generally cover these expenses.

Neither do they include expenses for a trip outside Québec by the future parents of a child residing in Canada outside Québec, whether the trip is made to allow the child to familiarize itself with the future parents or bring the child to Québec.

While many Canadian organizations involved in the adoption of such a child cover all the travel and living expenses of the adoptive parents, some cover only part of these expenses.

To better recognize the travel and living expenses involved in the adoption of a child, adjustments will be made to the tax legislation so that, in particular, the eligibility of such expenses is established regardless of where the adopted child is from.

More specifically, the tax legislation will be amended to stipulate that all the travel and living expenses of an individual and, if applicable, his spouse that are paid regarding the adoption of a child by the individual may be included in calculating the expenses eligible for the tax credit, provided the trip made was necessary.

For greater clarity, the eligibility of travel and living expenses will remain conditional on the fact that such expenses be paid after the opening, by the Minister of Health and Social Services or a certified agency, of the file relating to the adoption of a child, that they be reasonable under the circumstances and do not give rise to a refund.

This amendment will apply as of taxation year 2006. It will also apply to any taxation year of an individual for which the Minister of Revenue may, on the date of publication of this information bulletin, determine or determine anew the tax payable by such individual, for such year, and make an assessment or a new assessment, or establish a supplementary assessment.

2.3 Increase of the cap on the refundable tax credit for the production of shows

The refundable tax credit for the production of shows covers labour expenditures attributable to services supplied for the production of eligible shows. The tax credit is equal to 29.1667% of the amount of eligible labour expenditures, which are limited, however, to 45% of the eligible production expenses of the show.

Furthermore, the tax credit, for an eligible show, may in no event exceed $262 500.

Since this tax credit was introduced in 1999, Québec production of musical comedies and other major shows has flourished.

Also, the production costs of such shows are such that the current maximum amount of tax assistance granted is often reached in the first phase of the show, i.e. the period covering pre-production of the show until the end of the first full year following its initial public performance.

To further support shows with larger budgets, the cap on the tax credit for the production of shows will be increased.

More specifically, the legislation will be amended to stipulate that the tax credit, regarding an eligible show, may not exceed $750 000.

This amendment will apply regarding a show for which one of the three eligibility periods for which a tax credit may be claimed is not completed on the day of publication of this information bulletin.

2.4 Clarification to the fiscal policy concerning outsourcing contracts and certain tax incentives

Many tax incentives are designed to favour job creation in Québec. The method used to measure such job creation is often the increase in payroll generated by the type of activities covered by the fiscal measure.

As an integrity measure, the existing rules stipulate appropriate adjustments so that a corporation cannot receive a tax benefit regarding the increase in its payroll resulting from the continuation of a business[23] previously carried on in Québec by another taxpayer. Similarly, adjustments are also stipulated for alienations of businesses. These adjustments are justified by the fact that such transfers of activity do not create, on an overall basis, jobs in Québec.

Such transfers of activity can also occur in the course of outsourcing contracts. This does not mean, in this case, business continuation in the strict sense, but the net result, in terms of job creation, is the same. While earlier announcements did not refer to it specifically, the spirit of fiscal policy in this matter has always been to treat cases of outsourcing the same way as those of business continuation or alienation.

However, there appears to be some uncertainty as to the fiscal policy to be applied in outsourcing situations. Accordingly, the fiscal policy is being clarified to specify that outsourcing contracts must be treated the same way as business continuations and alienations.

For example, outsourcing can be defined as the fact, for a producer, of obtaining physical goods or services from outside sources rather than supplying them from its own resources.

This clarification applies to the fiscal measures for which the increase in payroll is used to determine a taxpayer's eligibility, or the base for the tax assistance. These measures are:

— the tax credit for job creation relating to the aluminum industry in the Saguenay–Lac-Saint-Jean region;

— the tax credit for job creation in Gaspésie and certain maritime regions of Québec;

— the tax credit for processing activities in resource regions;

— the refundable tax credit for biotechnology development in certain designated sites;

— the tax holiday for a major investment project;[24];

— the tax credit for job creation in the optics industry in the Québec City region;

— the tax credit for job creation in the manufacturing or environmental sector in the Technopôle Angus;

— the tax credit for e-business activities carried out in certain designated sites;[25]

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23 To avoid burdening the text, reference is made only to the notion of business although parts of businesses are also covered.

24 In the specific case of this fiscal measure, this clarification concerning outsourcing contracts applies both to the achieving of the eligibility threshold and for determining the base of the tax holiday.

25 Premises located either in the Montréal E-Commerce Zone or the CNNTQ.

— the refundable tax credit for nutraceuticals and functional foods;

— the refundable tax credit for innovation centres.

Lastly, this clarification of fiscal policy is intended only to clarify it regarding outsourcing contracts and applies to all these fiscal measures as if it had always referred to it.

2.5 Technical change concerning the interaction of certain tax incentives and the election to capitalize certain borrowing costs

A taxpayer who incurs certain borrowing costs in the course of acquiring a depreciable property may elect to capitalize them in the cost of the acquired property. Similarly, a taxpayer who incurs certain borrowing costs incidentally to making exploration or development expenses, can elect that such borrowing costs be considered as such exploration or development expenses, as the case may be.

Briefly, such an election allows a taxpayer not to increase a loss he fears he will be unable to carry over within the allowed time period, or allows him to increase his income in order to utilize a loss from a prior year.

Under the existing rules, the elections indicated above may have an impact on certain tax incentives, refundable tax credits based on the capital cost of certain assets in particular. Accordingly, a taxpayer who elects to capitalize borrowing costs may receive tax assistance that is enhanced regarding certain tax incentives.

This situation is different from the one that prevails in the federal tax legislation regarding the investment tax credit. The *Income Tax Act* (federal) (I.T.A.) specifically stipulates, in the calculation of the investment tax credit base, the exclusion of interest a taxpayer elects[26] to capitalize in the cost of an asset allowing such taxpayer to benefit from a tax credit.

As for the *Taxation Act* (T.A.), it contains no provision similar to that of the I.T.A. As a result, the tax assistance a taxpayer may receive regarding an asset may vary depending on his election whether or not to capitalize the interest relating to the financing of the asset. Such a situation is not justified and it is expedient to apply the necessary remedies.

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26 Note that this clarification covers only the interest that a taxpayer "elects" to capitalize, in contrast to interest that must be added to the cost of the good and cannot immediately be charged to expenditure. Such is the case with interest incurred during the period of construction of a building that, subject to certain exceptions, must be capitalized.

More specifically, the borrowing costs that a taxpayer elects to capitalize in the capital cost of an asset will no longer be part of the base on which the tax credits and capital tax credit regarding certain types of investments are calculated. Similarly, this change will apply (for the purposes of calculating the base of the tax credit for mine, oil, gas or other resources) to the borrowing costs a taxpayer incurs incidentally to making exploration or development expenses, and for which the taxpayer may elect to have such borrowing expenses considered as such exploration or development expenses, as the case may be.[27] In other words, the base of these fiscal measures will be calculated regardless of the election to capitalize borrowing costs.

This change will apply to all tax credits stipulated by the T.A. concerning assets in relation to which an election to capitalize borrowing costs is possible, as well as to the capital tax credit regarding certain types of investments for which an election to capitalize borrowing costs is also possible.

This change will apply regarding an election to capitalize borrowing costs made after the publication date of this information bulletin.

2.6 Recognition of new eligible public research centres

A taxpayer may obtain a refundable tax credit for university R&D of 35% in relation to scientific research and experimental development (R&D) activities where such activities are carried out by an eligible public research centre, under a contract the taxpayer concludes with such centre.

In this regard, it is the responsibility of the ministère des Finances to recognize a research centre as an eligible public research centre.

More specifically, to be recognized as an eligible public research centre for the purposes of the tax credit for university R&D, a research centre must demonstrate its capacity, in terms of human, material and financial resources, to carry out R&D work on behalf of businesses. Accordingly, the employees must have the qualifications needed to carry out the R&D work sub-contracted to the research centre, and the research centre must have premises and equipment that enable it to carry out such work in its field of expertise.

In addition, the research centre must obtain most of its financing from public funds.

Two new research centres will be recognized for the purposes of the tax credit for university R&D, namely the Centre de développement bioalimentaire du Québec Inc. (CDBQ) and the Centre d'expertise en production ovine du Québec Inc. (CEPOQ).

In the case of the CDBQ, such recognition will apply regarding R&D carried out after October 23, 2005, under an eligible research contract concluded after that date and, in the case of the CEPOQ, regarding R&D carried out after May 1, 2006, under an eligible research contract concluded after that date.

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27 Note that this change will have no impact concerning the flow-through system, first because it is not a tax credit and, second, because the equity financing of exploration does not involve an interest expense for the corporation that obtains this type of financing.

It should also be recalled that all the research centres that, since May 2, 1991, the ministère des Finances has recognized as eligible public research centres for the purposes of the tax credit for university R&D, must now annually confirm with the ministère des Finances that they satisfy the eligibility criteria listed above. This annual return relates to a calendar year and must be filed no later than the last day of February following such calendar year.

Lastly, an eligible public research centre must advise the ministère des Finances as soon as a change occurs, regarding human, material or financial resources, that could compromise its capacity to carry out R&D work on behalf of companies or to satisfy the requirement relating to the source of its financing.